

Supplemental Memorandum

To: STATE BOARD MEMBERS

Date: April 29, 2003

From: Susan Lange

Re: ITEM # 27

Subject PERMANENT REGULATIONS PERTAINING TO ANNUAL FINANCIAL REPORTING FOR ALL K-12 LOCAL EDUCATIONAL AGENCIES, INCLUDING CHARTER SCHOOLS, AS REQUIRED BY ASSEMBLY BILL 1994 (CHAPTER 1058, STATUTES OF 2002)

The materials provided in this Supplemental Item are in support of Item 27 submitted earlier requesting the Board to take action to commence the rulemaking process to adopt regulations for the forms used by school districts, county offices of education, joint powers agencies, and charter schools for annual financial reporting.

Regulations on financial reporting were presented at last month's State Board meeting. However, questions were raised regarding financial reporting for charter schools, and adoption of the regulations was postponed. The questions raised by the Board were:

1. Does requiring charter schools to follow the guidance in the *California School Accounting Manual* (CSAM) impose an extraordinary burden on them?
2. Is the proposed alternative form compatible with the standardized account code structure?
3. Is it appropriate to make the alternative form for charter schools available for a specified period of time, and if so, what time frame?

The regulations have been revised to clarify that charter schools must follow the guidance in the CSAM only to the extent necessary for accurate financial reporting. For illustration, we have attached examples of guidance that we believe would apply to charter schools and would be necessary to ensure accurate financial reporting.

The alternative form for charter schools is compatible with one of the seven fields in the standardized account code structure, the object field. The object field describes the service or commodity obtained as a result of a specific expenditure (e.g., salaries, books, and capital outlay).

The regulations have also been revised to make the alternative form available to charter schools without the time constraints previously proposed. Charter schools may use either SACS or the alternative form for reporting their annual financial statements.

Please see the following attachments:

- [Attachment 1:](#) Proposed Regulations to Implement Financial Reporting Provisions of AB 1994
(Pages 1-3)
- Attachment 2: Charter School Unaudited Actuals Financial Report – Alternative Format
(Pages 1-5) (This is not available on the web)
- [Attachment 3:](#) Initial Statement of Reasons (Pages 1-3)
- [Attachment 4:](#) Notice of Proposed Rulemaking (Pages 1-3)
- [Attachment 5:](#) Examples of Guidance from the *California School Accounting Manual*
(Pages 1-4)

**PROPOSED REGULATIONS TO IMPLEMENT
FINANCIAL REPORTING PROVISIONS OF AB 1994**

Title 5. EDUCATION

Division 1. State Department of Education

Chapter 14. School Finance

Subchapter 2. Budgeting, Accounting and Reporting

Add Article 2 (commencing with Section 15060) to read:

Article 2. Standardized Account Code Structure

§15060. Standardized Account Code Structure.

(a) The California School Accounting Manual adopted by the State Board of Education pursuant to Education Code Section 41010 shall incorporate a standardized account code structure which is a statewide, uniform financial reporting format (based on the definitions and comprehensive chart of accounts set forth in the California School Accounting Manual). The structure shall be designed to provide a flexible statewide accounting system for local educational agencies to use in budgeting and reporting their revenues and expenditures. The structure shall accommodate local, state, and federal reporting needs as determined by the State Board.

(b) The standardized account code structure shall include, but not be limited to, the following fields:

(1) Fund/Account Group. Each fund is a fiscal and accounting entity, with a self-balancing set of accounts recording cash and other resources, all related liabilities and residual equities and balances or changes therein. Fund types include, but are not limited to, Governmental Funds, Proprietary Funds, Fiduciary Funds, and Account Groups.

(2) Project Year. The project year field is used to distinguish the activities of the same grant with different project years within the fiscal year.

(3) Resource (Project/Reporting). The resource field identifies the source of funding and is used for accumulating revenues and expenditures to meet various specialized reporting requirements and tracking categorical activities, such as No Child Left Behind (NCLB) Act, Economic Impact Aid, and School Improvement Program.

1 (4) Goal (Program). The goal field defines the objective, such as the target population being served
2 or the education mode (e.g., regular education, special education, or vocational education).

3 (5) Function. The function field describes the activity being performed for which a service or material
4 object is acquired, for example, instructional services, pupil services, and general administration.

5 (6) Object. The object field describes the service or commodity obtained as a result of a specific
6 expenditure (e.g., salaries, books, and capital outlay).

7 (7) Site. The site field is optional, providing local educational agencies the ability to designate
8 specific school sites within their individual accounting systems.

9 NOTE: Authority cited: Section 33031, Education Code. Reference: Sections 41010, Education Code.

10
11 *Add Article 3 (commencing with Section 15070) to read:*

12 **Article 3. Annual Financial Statements**

13 **§15070. Submission of Annual Financial Statements**

14 Except as provided in Section 15071, every county office of education, school district, charter school,
15 and educational joint powers agency (as defined in Education Code Section 41023) shall submit an annual
16 statement of receipts and expenditures in the format of the standardized account code structure, subject to
17 the provisions of Section 39 of Chapter 299, Statutes of 1997. The form(s) for the annual statement shall
18 be adopted by the State Board of Education and may be periodically revised (without separate approval of
19 the State Board of Education) by the State Superintendent of Public Instruction to the extent necessary to
20 accommodate changes in statute or generally accepted accounting principles for government agencies.

21 NOTE: Authority cited: Section 33031, Education Code. Reference: Education Code Sections 1628,
22 41023, and 42100.

23 **§15071. Alternative Form for Submission of Annual Financial Statements by Charter Schools**

24 (a) Charter schools have the option of reporting their annual financial statements using an alternative
25 form adopted by the State Board of Education. The alternative form may be periodically revised (without
26 separate approval of the State Board of Education) by the State Superintendent of Public Instruction to the
27 extent necessary to accommodate changes in statute or generally accepted accounting principles for
28 government agencies. The alternative form shall be structured for electronic submission of data,
29 including the following information:

1 (1) Revenues. An accounting of all funds received during the preceding fiscal year, including
2 identification of specific details within the major revenue categories of revenue limit sources, federal
3 sources, other state sources, and other local sources.

4 (2) Expenditures. An accounting of all funds expended during the preceding fiscal year, including
5 identification of specific details within the major expenditure categories of certificated salaries, classified
6 salaries, employee benefits, books and supplies, services and other operating expenses, capital outlay, and
7 other outgo.

8 (3) Other Information. An accounting of additional information including beginning and ending fund
9 balances, other sources and uses, assets, liabilities, and reserves.

10 (b) (1) The reporting of financial data by charter schools that are established as governmental
11 accounting entities shall reflect the definitions, and to the extent necessary for accurate financial
12 reporting, the guidance provided in the California School Accounting Manual.

13 (b) (2) The reporting of financial data by charter schools that are established as nongovernmental
14 accounting entities shall reflect the definitions, and to the extent necessary for accurate financial
15 reporting, the guidance provided in the California School Accounting Manual, except for accounting
16 differences required due to their nonprofit status.

17 NOTE: Authority cited: Section 33031, Education Code. Reference: Education Code Sections 1628,
18 41023, and 42100.

INITIAL STATEMENT OF REASONS

SPECIFIC PURPOSE OF THE REGULATIONS

Section 15060. Standardized Account Code Structure

The purpose of the regulation is to define the current accounting and reporting format prescribed in the California School Accounting Manual (CSAM), as approved by the State Board of Education, for local educational agencies to use in recording their financial affairs. Education Code Section 41010 requires the accounting format to be in accordance with the definitions, instructions, and procedures published in the CSAM. Although not currently defined in regulations, the accounting format described in the CSAM is the standardized account code structure (SACS).

Necessity/Rationale

SACS was developed in response to legislation enacted in 1993 (Senate Bill 94, Chapter 237). According to SB 94, the legislature intended to develop a new statewide budgeting and accounting model that would accomplish the following: 1) enable the public to be more informed about public school revenues and expenditures, 2) eliminate duplicate reporting, 3) ensure accurate and timely reporting of statewide data to ensure accurate allocations of federal funds, 4) ensure that adequate accounting flexibility exists to support school site budgetary decision-making, 5) support financial integrity and stability, and 6) expand the fiscal information capability of the California Department of Education (CDE) without adding costly or time-consuming reporting requirements.

SACS is basically a detailed chart of accounts whereby most financial transactions are coded with six key elements: fund, resource, project year, goal, function and object. What this detailed chart of accounts means is that each expenditure transaction tells a complete story (such as, what categorical program paid for the expenditure, what the expenditure was made for (e.g., textbooks or supplies), who is going to benefit from the expenditure (e.g., regular education students or Regional Occupational Programs (ROP) students), and the activity being performed (e.g., instruction or transportation).

Since 1993, nearly all local educational agencies (LEAs) have been converting their accounting systems to the SACS format, with the help of fiscal incentives provided by the Legislature. By the end of 2003-04, it is expected that all LEAs will have converted to SACS, and the “old” format (commonly known as the J-200 Annual Budget and Financial Report) will no longer be available. The process of converting typically takes one to two years per LEA, but given the magnitude of implementing the process statewide, the conversion has taken nearly ten years. There have been a few instances in the past of LEAs being unable to implement the SACS system of accounting in their established timeframes, and they have needed to obtain an

extension to their implementation date. Pursuant to current law, an extension may be allowed on a case-by-case basis upon application to the Superintendent of Public Instruction (Chapter 299, Statutes of 1997).

Section 15070. Submission of Annual Financial Statements

The proposed regulation will fulfill the requirement in Education Code sections 1628 and 42100 that the forms for all local educational agencies to report their annual statement of all receipts and expenditures for the preceding fiscal year be prescribed by the Superintendent of Public Instruction and adopted in regulations by the State Board of Education. This section also applies to charter schools unless they choose to report in the alternative format pursuant to Section 15071.

Necessity/Rationale

Prior to the amendments to Education Code sections 1628 and 42100, all school districts, county offices of education, and joint powers agencies (JPAs) were required by sections 1628 and 42100 to submit annual financial data to the State on forms prescribed by the State Superintendent of Public Instruction. Assembly Bill (AB) 1994 (Chapter 1058, Statutes of 2002) amended sections 1628 and 42100 to require that the forms for reporting the annual financial data be adopted in regulations by the State Board of Education. The proposed regulations will formalize the existing reporting requirement.

Section 15071. Alternative Form for Submission of Annual Financial Statements by Charter Schools

The purpose of this regulation is to provide an alternative financial report form to the standardized account code structure format described in Section 15060 for charter schools.

Necessity/Rationale

CDE developed an alternative form for those charters that prefer not to report in the standardized account code structure described in Section 15060. The alternative form will allow charter schools to comply with the requirement to report financial data, but in a format quite similar to the old J-200 format that is so familiar to local educational agencies. The alternative form is designed to provide very basic summary level detail. The data can be imported from charter systems or be manually input so that the data can be provided electronically to CDE, as are the data provided by all other school districts, county offices of education, and joint powers agencies.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The State Board did not rely upon any other technical, theoretical, or empirical studies, reports, or documents in proposing the adoption of these regulations.

REASONABLE ALTERNATIVES TO THE REGULATIONS AND THE AGENCY'S REASONS FOR REJECTING THOSE ALTERNATIVES

The State Board was not presented with other alternatives to the adoption of these regulations.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The State Board has not identified any alternatives that would lessen any adverse impact on small business.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The proposed regulations would not have a significant adverse economic impact on any business because they apply to reports from school districts, county offices of education, educational joint powers agencies, and charter schools. The proposed regulations do not impose additional workloads on small businesses or contractors funded by the Department.

Notice of Proposed Rulemaking

Proposed Regulations to Implement Financial Reporting Provisions of AB 1994

AUTHORITY AND REFERENCE

Authority for these regulations is found in the following Education Code sections: (a) 33031; (b) 33050; (c) 1628; (d) 41010; (e) 42100; and Chapter 299 of the Statutes of 1997.

- (a) Education Code Section 33031 is the State Board's general authority to adopt rules and regulations for the government of the day and evening schools of the state.
- (b) Education Code Section 33050 is the State Board's general authority to waive, with some listed exceptions, all or part of any section of the Education Code or any regulation adopted by the State Board of Education that implements a provision of the Education Code.
- (c) Education Code Section 1628, as amended by Assembly Bill 1994, Chapter 1058, Statutes of 2002, requires that the State Board of Education adopt as regulations the format prescribed by the State Superintendent of Public Instruction for the annual financial statements of the county offices of education. Section 1628 also allows the State Superintendent of Public Instruction to amend the forms periodically to accommodate changes in statute or government reporting standards.
- (d) Education Code Section 41010 requires that the accounting system used to record the financial affairs of any school district shall be in accordance with the definitions, instructions, and procedures published in the California School Accounting Manual as approved by the State Board of Education and furnished by the Superintendent of Public Instruction.
- (e) Education Code Section 42100, as amended by Assembly Bill 1994, Chapter 1058, Statutes of 2002, requires that the State Board of Education adopt as regulations the format prescribed by the State Superintendent of Public Instruction for the annual financial statements of the school districts and charter schools. Section 42100 also allows the State Superintendent of Public Instruction to amend the forms periodically to accommodate changes in statute or government reporting standards.

- (f) Section 39 of Chapter 299 of the Statutes of 1997 (Assembly Bill 1578) provides funding for the implementation of the standardized account code structure under specified timelines. Chapter 299 also provides for a waiver of those timelines and repayment of the implementation funds in the event that the standardized account code structure is not implemented.

References are made to Education Code sections 1628, 41010, 41023, and 42100. These statutes govern the accounting system and the annual financial statements required of all school districts, county offices of education, charter schools, and educational joint powers agencies (JPAs), and prescribe the process of how and when these reports are transmitted to the Superintendent of Public Instruction.

Prior to the AB 1994 amendments to Education Code sections 1628 and 42100, local educational agencies were required to prepare and submit their financial reports on forms prescribed by the Superintendent of Public Instruction, but there was no requirement that the forms be adopted as regulations by the State Board of Education.

INCORPORATION BY REFERENCE

These regulations incorporate by reference the California School Accounting Manual (Sections 15060 and 15071 of the regulations) and the standardized account code structure (SACS) Unaudited Actuals Financial Report forms (Sections 15070 and 15071 of the regulations). These items can be found on our Web site pages at www.cde.ca.gov/fiscal/software and www.cde.ca.gov/fiscal/sacs.

Note: The California School Accounting Manual is updated every year, usually in December (the most recent edition is December 2002). The SACS report forms are updated every year, usually in April and July (April 2003 is the latest edition).

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

The Board proposes to adopt Section 15060 in Article 2 and sections 15070 and 15071 in Article 3 of Division 1, Chapter 14, Subchapter 2 of Title 5 of the California Code of Regulations. These sections concern the accounting system

and the format for the annual financial statements for school districts, county offices of education, educational joint powers agencies, and charter schools.

The purpose of the regulations is 1) to define the current accounting and reporting format used to record the financial affairs of local educational agencies, 2) to adopt the forms that are prescribed by the Superintendent of Public Instruction for local educational agencies to report their annual statement of all receipts and expenditures for the preceding fiscal year, and 3) to provide an alternative annual financial statement form for charter schools.

CONTACT PERSONS

Inquiries concerning the substance of the proposed regulations should be directed to:

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Examples of Guidance in the California School Accounting Manual

Example 1 - Revenue Recognition, excerpted from Procedure 302

In governmental funds, in which the modified accrual basis of accounting is used, revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the fiscal period. The term *available* means collectible within the current period or soon enough thereafter to be used to pay the liabilities of the current period.

Generally, *available* is defined as collectible within 45, 60, or 90 days. However, to achieve comparability of reporting among California LEAs and so as not to distort normal revenue patterns, with specific respect to reimbursement grants and corrections to state aid apportionments, the California Department of Education has defined *available* as collectible within one year. See below for a discussion of revenue recognition for specific revenue sources.

In proprietary funds, in which the accrual basis of accounting is used, revenues are recognized as soon as they are earned.

LEAs receive revenue in one of two ways: 1) through *exchange transactions*, in which both parties exchange equal value, such as a contract for services; or 2) through *nonexchange transactions*, in which the LEA receives value without directly giving equal value in return, such as receipt of state apportionments, state or federal categorical grants, and local property taxes. Most revenues received by LEAs are the result of nonexchange transactions.

In governmental funds, recognition of revenues from exchange and exchange-like transactions occurs as soon as the exchange has occurred and the revenues become available.

Recognition of revenues from nonexchange transactions varies depending on the characteristics of the nonexchange transaction. GASB 33, *Accounting and Financial Reporting for Nonexchange Transactions*, which took effect in June 2000, defines four classes of nonexchange transactions:

- *Derived tax revenue* is from assessments imposed by governments on exchange transactions. Examples include sales tax or income tax. Derived tax revenues are recognized in the period when the underlying exchange transaction occurs and the resources are available. Typically, LEAs do not assess taxes or directly receive derived tax revenues.
- *Imposed nonexchange revenue* is from assessments by governments on nongovernmental entities, including individuals, other than assessments on exchange transactions. Examples include ad valorem property taxes and fines. Generally, using modified accrual accounting, property tax revenues are recognized in the period for which they are assessed and become

available. However, see below for discussion of revenue recognition for property taxes for California LEAs.

- *Government-mandated nonexchange revenue* is from a government at one level providing resources to a government at another level, requiring the recipient to use the resources for a specific purpose. An example is the state apportionment for providing required educational services. Under modified accrual, government-mandated nonexchange revenue is recognized when all applicable eligibility requirements have been met and the resources are available.
- *Voluntary nonexchange revenue* is from legislative or contractual agreements, other than exchange transactions, entered into willingly by two or more parties. Examples are donations, grants, or entitlements entered into by an LEA through an application process. Under modified accrual accounting, voluntary nonexchange revenue is recognized when all applicable eligibility requirements have been met and the resources are available.

Generally accepted accounting principles (GAAP) requires that when both parties to a nonexchange transaction are governments, recognition generally should be symmetrical. That is, when the provider government is required to recognize a liability, the recipient government should recognize an asset. GAAP further requires that when the provider is a government, an appropriation is essential to make enabling legislation effective for a particular period of time. A government does not have a liability to transmit resources under a particular program, and a recipient does not have a receivable, unless an appropriation for that program exists.

Example 2 – Accounting for Expenditures and Other Financing Uses, excerpted from
Procedure 401

Expenditures

Expenditures are decreases in net spendable resources. They include expenses (the term used in the proprietary funds), payments toward the retirement of long-term debt, and capital outlay for acquisition of long-term assets, such as land, buildings, and equipment.

Account numbers 1000–7499 and 7651–7699 are used to record a local educational agency's (LEA's) expenditures.

Interfund Transfers

Interfund transfers are flows of assets without equivalent flows of assets in return and without a requirement for repayment. The two major categories of interfund transfers are:

1. *Residual equity transfers.* Residual equity transfers are nonrecurring or nonroutine transfers of equity between funds. Examples of transfers of this type are (1) transfers of residual balances of discontinued funds to the General Fund; and (2) nonroutine contributions of Internal Service Fund capital by the General Fund.
2. *Operating transfers.* Operating transfers, which comprise all interfund transfers other than residual equity transfers, are routine, legally authorized transfers between funds. Examples of operating transfers are (1) transfers from the General Fund to a Special Revenue or Capital Projects Fund; and (2) operating subsidy transfers from the General Fund to an Enterprise Fund.

Both residual equity transfers and operating transfers are nonreciprocal interfund activities. Reciprocal interfund activities, such as interfund loans and interfund services provided and used, are not recorded as interfund transfers.

Interfund transfer accounts are closed at the end of the fiscal year in the same manner as that used for closing expenditure accounts.

Account numbers 7610–7629 are used to record an LEA's interfund transfers.

Recognition of Expenditures and Operating Transfers

Expenditures of governmental funds are accounted for on the *modified accrual basis*. Expenditures, if measurable, are therefore recorded (recognized) during the accounting period in which liabilities are incurred. The only exception is unmatured interest on general long-term debt.

Policies governing expenditure recognition will continue as currently established:

1. Expenditures and transfers out are recorded when the related liabilities, if measurable, are incurred except for unmatured interest on general long-term debt, which is recognized when due.
2. Accruals for accounts payable at the end of the fiscal year are recorded for services rendered or for goods received by June 30.

Expenses of proprietary and trust funds are accounted for on the *accrual basis*. Expenses, if measurable, are recognized during the period in which they are incurred.

Transfers out are recognized during the accounting period in which the interfund transfer obligation arises.

Recognition of Legal Obligations in Reporting for Federal Grants

Legal obligations are commitments made by an LEA to purchase goods or services immediately or in a future period. Commitments are generally made in the form of a purchase order or a written contract. For purposes of accounting at year-end, obligations for future periods are not reflected in the current year's books. Rather, the obligated goods or services are recognized in the following year's books, when the goods or services are actually received.

But for purposes of grant reporting, federal funding may be claimed under a current-year grant for certain qualifying legal obligations incurred by the end of the grant period, even though the goods or services will not be received until after the grant period ends. *The question of whether or not an obligation is claimable for funding under a current-year grant is determined by what the obligation is for.* The following illustration from the Education Department General Administrative Regulations (EDGAR) *Code of Federal Regulations (CFR), Title 34, Part 76.707*, shows when various commitments are considered to be legal obligations.

<i>If the obligation is for . . .</i>	<i>The legal obligation is made . . .</i>
Acquisition of real or personal property	On the date on which the LEA makes a binding written commitment to acquire the property
Personal services by an employee of the LEA	When the services are performed
Personal services by a contractor who is not an employee of the LEA	On the date on which the LEA makes a binding written commitment to obtain the services
Performance of work other than personal services	On the date on which the LEA makes a binding written commitment to obtain the work
Public utility services	When the LEA receives the services
Travel, conferences	When the travel is taken or conference attended
Rental of real or personal property	When the LEA uses the property